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RM 7626
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MAR 21 1991

FEDERAL COMMUNICATIONS COMMISSION
OFFICE OF THE SECRETARY

March 21, 1991

Ms. Donna Searcy
Secretary
Federal Communications Commission
Room 222
1919 M Street NW
Washington, D.C. 20554

RM-7626

Re: Opposition to Petition for Rulemaking

Dear Ms. Searcy,

Enclosed herewith for filing are the original and nine (9) copies of MCI Telecommunications Corporation's Opposition to Petition for Rulemaking.

Please acknowledge receipt by affixing an appropriate notation on the copy of the MCI Petition furnished for such purpose and remit same to the bearer.

Yours truly,

Carol Schultz, Esq.
Federal Regulatory Policy

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MAR 21 1991

Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, DC 20554

FEDERAL COMMUNICATIONS COMMISSION
OFFICE OF THE SECRETARY

RM 2626

In the Matter of:)
)
The Allowance for Funds Used During)
Construction (AFUDC) Rate Properly)
Charged By Dominant Carriers For)
Ratemaking and Other Purposes)

OPPOSITION TO PETITION FOR RULEMAKING

MCI Telecommunications Corporation (MCI) hereby opposes The Ameritech Operating Companies' (Ameritech's) Petition for Rulemaking. The Commission's existing rules do not allow the cost of Plant Under Construction - Long Term (PUC-LT) to be included in the rate base because these costs do not benefit current ratepayers.¹ However, an Allowance for Funds Used During Construction (AFUDC) representing the "[r]easonable amounts of interest during the construction period"² is added to the amount that will be transferred to Total Plant in Service (TPIS), and thus included in the ratebase, when the project is completed. The Commission's well established and reconfirmed policy is for AFUDC to be computed using the

¹ See, 47 C.F.R. Section 32.2004 and Section 65.820. PUC-LT is defined as long term construction projects designed to be completed in more than one year. 47 C.F.R. Section 32.2004.

² 47 C.F.R. Section 32.2000(c)(2)(x)(A).

"compound prime rate of interest."³

Ameritech requests the Commission modify its existing rule to replace the "compound prime rate of interest" with "the Commission's most recently authorized or prescribed rate of return" as the interest rate to be used for accruing AFUDC.⁴ Ameritech also proposes that AFUDC amounts be included in the current rate base as if such capitalized interest were part of TPIS.⁵ MCI will demonstrate below that Ameritech's proposed rules would undermine the Commission's well reasoned policy basis for its current rules, and that Ameritech has completely misinterpreted the governing legal standard and prior Commission decisions. Thus, the "facts" and assertions presented by Ameritech are irrelevant, and it has failed to "disclose sufficient reasons in support of the action requested," as required in the Commission's rules.⁶ MCI therefore respectfully requests that the Commission deny Ameritech's Petition.

³ See, AT&T - Charges for Interstate Services, 64 F.C.C.2d 1 (1977), recon., 67 F.C.C.2d 1429 (1978), and Amendment of Part 65 of the Commission's Rules to Prescribe Components of the Rate Base and Net Income of Dominant Carriers, 3 FCC Rcd 269, 273 para. 32 (1987), recon., 4 FCC Rcd 1697, 1703 para. 56.

⁴ Ameritech Petition, p. 5. Ameritech also proposes in a footnote that an alternative would be to include PUC-LT in the rate base. However, Ameritech has not included this recommendation in the text of the proposed rule included in its Petition. See, Ameritech Petition pp. 5-6.

⁵ Id., p. 6.

⁶ 47 C.F.R. Section 1.407.

I. AMERITECH'S PROPOSED RULE WOULD CONFLICT WITH COMMISSION POLICY, FORCING CURRENT RATEPAYERS TO BEAR THE COST OF FUTURE CONSTRUCTION

Ameritech proposes that AFUDC, which is clearly a cost of future construction, be included in the current ratebase.⁷ However, the Commission's long established rules appropriately recognize the inequities of requiring current ratepayers to bear the cost of future construction.

In Docket No. 19129 (Phase II),⁸ the Commission carefully considered the issue and concluded that long-term construction projects were not useful to current ratepayers, and therefore "... investors are not necessarily entitled to receive from the ratepayers the rate of return prescribed for it until the plant is placed into service."⁹

⁷ Ameritech Petition at para. 8. Although Ameritech has not directly proposed a rule that would include PUC-LT in the ratebase, Ameritech also suggested in a footnote that in the alternative PUC-LT be included in the rate. See, Ameritech Petition at n. 11 and Attachment A.

⁸ AT&T - Charges for Interstate Services, 64 F.C.C.2d 1 (1977), recon., 67 F.C.C.2d 1429 (1978). (Docket No. 19129).

⁹ Id. at p. 60. The Commission also noted: "We find it unreasonable and clearly not in the public interest for AT&T or this Commission to burden current ratepayers with a project (e.g. construction of a new coaxial cable) that will not be placed into service for 5 to 8 years. While most AT&T construction projects are completed within one year, many of the longer term projects involve large capital investments and thus can have a significant rate-base impact. We believe it is reasonable to separate such large, costly, longer-term projects from the smaller, less costly, short-term projects. To this extent, we find it both feasible and necessary to distinguish between current and future ratepayers." Id. at p. 59.

The Commission's decision was specifically upheld by the court.¹⁰

Basically, Ameritech now suggests that it receive from current ratepayers, the prescribed rate of return on the capitalized return which will eventually be recovered from future ratepayers. Ameritech has advanced no rational justification for such a modification, which is a radical departure from the Commission's established policy. MCI respectfully requests that the Commission deny Ameritech's Petition to consider a rule that is so obviously in conflict with the Commission's goals.

¹⁰ See, *Illinois Bell Telephone v. F.C.C.* 911 F.2d 776 (D.C. Cir 1990) (*Illinois Bell*) at p. 781. Ameritech has not directly proposed to change this prior ruling, but does include an Attachment to its Petition that would allegedly demonstrate that ratepayers will pay higher rates as a result of capitalizing AFUDC rather than including PUC-LT in the ratebase. It is odd that Ameritech should be so interested in the ratepayers welfare concerning excluding the PUC-LT from the ratebase, when Ameritech's Petition proposes a rule that will result in higher rates. Although the exclusion of PUC-LT from the ratebase is well established and Ameritech has not properly placed the issue up for consideration in its Petition, MCI is compelled to point out for the record that these examples contain calculation errors. Additionally, the parameters chosen by Ameritech are self-serving and the analysis fails to consider the time value of money.

Ameritech has made a significant clerical error in calculating the revenue requirement in Year 1 for the option of excluding the PUC-LT for the ratebase and including AFUDC. For Year 1, PUC-LT should have been excluded from the ratebase for the first half of the year when calculating revenue requirement. If Ameritech had appropriately performed the calculations, the base rate differential would have been reduced by over \$160,000 in each example presented.

Additionally, Ameritech has manipulated the revenue requirements under the two alternatives by its selection of parameters. The revenue requirement differential for the two alternatives outlined by Ameritech depends upon a combination of factors. The AFUDC rate, the LEC's cost of capital (the cost of capital for equity and debt and the debt/equity ratio), the length of the depreciation schedule, and the length of time that the plant is under construction all enter into the equation. Ameritech has simply chosen parameters that allegedly support its results. For example, if Ameritech had used an eight percent prime rate for accruing AFUDC, or a 5 year depreciation life, excluding PUC-LT would have resulted in a lower revenue requirement for excluding PUC-LT.

Finally, Ameritech's examples treat all cash outflows as if they were of equal value to ratepayers rather than discounting them to present value to account for the time value of money. Adjusting for the error that Ameritech made in calculating revenue requirement, and discounting to present value using even a modest interest rate of 8 percent would result in a cost benefit to Ameritech's ratepayers when PUC-LT is excluded from the ratebase.

II. AMERITECH'S PROPOSAL TO CHANGE THE COMMISSION'S DETERMINATION OF REASONABLE INTEREST ON LONG-TERM CONSTRUCTION IS UNNECESSARY AND IN CONFLICT WITH THE COMMISSION'S POLICIES

The Commission's rules currently provide for the recovery of "reasonable amounts of interest during the construction period" for PUC-LT. The Commission has interpreted this rule to require carriers to use the prime rate as the measure of "reasonable amounts." Ameritech asserts that "[s]etting the AFUDC rate at the prime rate is inconsistent with how telephone companies fund construction projects, the governing legal standard, and the Commission's policy of encouraging carriers to reinvest their earnings in their regulated businesses."¹¹ However, as MCI will demonstrate, Ameritech has grossly misinterpreted the court and Commission decisions on the reasonable amount of interest that would be allowable, and has, as a result, proposed a completely unreasonable rule that would substitute the carrier's "authorized or prescribed rate of return" for "reasonable amounts of interest."

When the Commission decided to defer including long-term construction in the ratebase in Docket 19129, the question arose as to how the investors would receive reasonable compensation for their investments. The Commission found that AT&T had the ability to obtain short-term funding at the prime rate, and it recognized that the most reasonable and equitable solution would be to require interest during construction (IDC) to be computed and compounded using that same rate.

¹¹ Ameritech Petition at p. 6.

The Commission stated:

The Bell System is presently charged the prime rate by financial institutions for its short-term debt and promissory notes. Such short-term funding presently constitutes a very

actual source of funding is irrelevant to the determination of a reasonable interest rate.¹⁴

Ameritech grossly misrepresents the legal standard governing the Commission's determination of a "reasonable" rate. Rather than relying upon the binding legal precedent and Commission decisions discussed above, Ameritech uses statements out of context to attempt to limit the Commission's discretion in determining the allowable AFUDC rate. For example, Ameritech quotes the Commission's statements about the purpose of AFUDC in a brief where a decision on the reasonable interest rate was not even before the court,¹⁵ but ignores the Commission's direct statements in its original rate base decision establishing the AFUDC. Ameritech has essentially proposed its own definition of the "full cost" of capital, and then tries to attribute that definition to the Commission.¹⁶ Yet the Commission has repeatedly required "reasonable interest" as the appropriate benchmark rather than some arbitrary, possibly more expensive, LEC determination of the appropriate funding. Ameritech's recommended rule is arbitrary. The prescribed rate of return would continue to compensate the LECs for a mix of capital that bears no relationship to the actual funding of long-term construction, and would also unduly compensate LECs for inappropriate funding.

¹⁴ Ameritech does not attempt to show in its petition that it cannot, or even that it has not obtained short-term debt at the prime rate. Even if Ameritech could make such a showing, the waiver process would be more appropriate than a rulemaking proceeding.

¹⁵ Ameritech Petition at p. 9. In *Illinois Bell*, the court properly refused to consider the merits of the Commission's decision on the rate to be used for AFUDC because the issue was not properly raised. See, *Illinois Bell* at pp. 782-783.

¹⁶ Ameritech Petition at p. 9.

In a final attempt to establish some reason for the Commission to change its time-honored policies, Ameritech asserts that a change in the rules will somehow encourage investment in the infamous "infrastructure." However, Ameritech does not indicate that it has had difficulty in attracting investors or funding long-term construction under the current rules. To the contrary, Ameritech's PUC-LT exceeded \$2 billion over the last few years.¹⁷ In reaching a decision on the use of the prime rate, the Commission reaffirmed its goals by stating:

...public interest considerations require that we provide such incentives as are necessary to insure efficient, low-cost communications services....Allowing IDC to accrue at a compounded prime rate provides adequate compensation to investors and encourages AT&T to complete construction as expeditiously as reasonably possible.¹⁸

When interest rates are low, including a higher return on long-term construction may actually discourage timely completion of projects by allowing uneconomic investment in PUC-LT as an alternative to TPIS to the detriment of the infrastructure. On the other hand, retaining the short-term interest rate (prime interest rate) for PUC-LT will further the Commission's goal of encouraging timely completion of construction projects and will appropriately compensate the LECs for the investment in long-term construction projects.

¹⁷ Ameritech Petition at p. 6.

¹⁸ Docket No. 19129 at 60.

III. CONCLUSION

The Commission's goals and its obligation to the public have not changed.

CERTIFICATE OF SERVICE

I, Marilyn Brundage, do hereby certify that copies of the foregoing MCI Petition were sent via first class mail, postage paid, to the following on this 21st day of March, 1991:

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